EFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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Order Instituting Rulemaking into the Review Of the California High Cost Fund B Program	Rulemaking 06-06-028

PHASE II COMMENTS OF AT&T CALIFORNIA (U 1001 C); AT&T ADVANCED SOLUTIONS INC. (U 6346 C); AT&T COMMUNICATIONS OF CALIFORNIA (U 5002 C); TCG SAN FRANCISCO (U 5454 C); TCG LOS ANGELES, INC. (U 5462 C); TCG SAN DIEGO (U 5389 C); AND AT&T MOBILITY LLC (NEW CINGULAR WIRELESS PCS, LLC (U 3060 C); CAGAL CELLULAR COMMUNICATIONS (U 3021 C); SANTA BARBARA CELLULAR SYSTEMS LTD. (U 3015 C); AND VISALIA CELLULAR TELEPHONE COMPANY (U 3014 C))

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In response to the Assigned Commissioner's Ruling Regarding the Scoping and Scheduling of Phase II Issues,[1] issued October 5, 2007, AT&T[2] hereby submits its comments on sequencing, coordination, design, and implementation issues relating to the reverse auction mechanism, cost proxy model updating, and on issues related to the transition mechanism for price caps.

I. INTRODUCTION

The Commission should proceed cautiously in implementing an auction process for supporting basic service in high-cost areas. Many details of such a process need to be decided. Because such an auction would be a first-time event in this country, AT&T suggests that it would be prudent to test the process through a pilot auction. The Commission also needs to make meaningful progress in allowing AT&T California's basic rates to reflect market conditions. AT&T's recommendation that caps be set to achieve prices in line with what other ILECs already charge for basic service is eminently reasonable and should be adopted.

II. DISCUSSION

2.1 Reverse Auction Design and Implementation

1. *Are there any statutory limitations to designating COLRs through an auction process?*

There do not appear to be any statutory provisions that would prevent the Commission from using an auction process *per se*. However, since 1996 the Commission has limited Fund B to the support of basic service, which the Commission has defined as including 17 required attributes.[3] As AT&T and several other parties observed in their comments regarding the proposed California Advanced Services Fund, that definition may exclude other technologies such as wireless and Voice over Internet Protocol ("VoIP") providers, which might otherwise be

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[1] As amended by ALJ Pulsifer's Ruling of October 19, 2007.

[2] AT&T California (U 1001 C); AT&T Advanced Solutions Inc. (U 6346 C); AT&T Communications of California (U 5002 C); TCG San Francisco (U 5454 C); TCG Los Angeles, Inc. (U 5462 C); TCG San Diego (U 5389 C); AT&T Mobility LLC (New Cingular Wireless PCS, LLC (U 3060 C); Cagal Cellular Communications (U 3021 C); Santa Barbara Cellular Systems Ltd. (U 3015 C); and Visalia Cellular Telephone Company (U 3014 C)).

[3] *Re Universal Service and Compliance with the Mandates of Assembly Bill 3643*, Decision No. 96-10-066, *Opinion*, 68 Cal. P.U.C.2d 524 (Oct. 25, 1996), *mimeo*, Appendix A, ¶ 4.B.

important bidders in any auction. To take a leading example, one required element of basic service is a Lifeline or ULTS offering, and the Commission has required that ULTS be tariffed.[4] Wireless and VoIP services are not tariffed, and thus would not satisfy the definition of basic service as it stands today. The Commission should consider updating the definition of basic service to ensure that other technologies can be used to provide universal service, and that other providers using alternative technologies may participate in any auction.

2. *What processes and protocols should be established to implement a reverse auction for purposes of assigning COLR obligations and setting the level of subsidy support in high-cost areas served by the existing incumbents? Is a descending bid, simultaneous-close auction the best type of auction to determine support?*

AT&T considers the processes and protocols for the reverse auction at three stages: (a) establishing the parameters before the auction occurs; (b) establishing the rules for the auction itself; and (c) defining the rights and responsibilities of the winning bidder.

A. The Commission Should Clearly Establish All Requirements For Participation And Support Before The Auction Begins.

It is critical that the Commission clearly define all the requirements for participating in the reverse auction – and all the obligations that the winner will assume – before the auction begins. The Commission should make clear that it will not make changes in the COLR's obligations during the term of those obligations. All bidders must have a clear understanding going in about just what they are bidding to obtain and what they will be committing to do in exchange. That way, all potential bidders can formulate their bids based on the same set of information and criteria. All bids will be fully informed, and the only variable will be the bid amount – meaning that the Commission's decision will be based on the straightforward and indisputably objective criterion of which bid is the lowest (as defined in Question 2B). Conversely, if bidders are uncertain about what they are getting into, they will either increase their bids (to reflect the risk that the Commission might change the rules after the auction is

[4] *See* G.O. 153 § 3.3.

over), decide to avoid the auction altogether, or unexpectedly find themselves unable to live up to changing commitments during the term.

At a minimum, the Commission must define up front the following criteria:

- Eligibility criteria (including financial fitness) for providers to participate in the auction
- Services that the COLR must offer
- Maximum rates that the COLR may charge for those services
- Service quality standards that the COLR must satisfy
- Geographic areas in which the COLR obligations will apply
- Reporting, recordkeeping, and audit requirements
- Any other regulatory requirements
- Term of the COLR obligation

In response to the Questions that follow, AT&T sets forth its recommendations for the above criteria, but two of these criteria warrant special mention. First, the COLR should assume the obligation to offer the required minimum service *in the area covered by the bid* at or below a maximum rate, to be established before the auction by the Commission. In order for the required service to be truly universal, it must be offered at an affordable rate. Of course, the rate cap and services governed by that cap must be established before the auction, so that providers can make an informed decision about whether and how much to bid. The Commission should set the rate in advance, based on competitive data, so that all providers bid on the same terms and the only variable is the bid amount. If the COLR obligation is to last for several years (see Question 3(b) below) the Commission should also adopt a schedule of rate increases or some other adjustment for inflation during the term.

Second, the Commission should clearly establish which services must be offered by the COLR. Generally speaking, the Fund should maintain its longstanding focus on basic service, but as described under Question 1, the definition and required elements of basic service should be updated so all technologies may participate in the auction.

B. The Auction Itself Should Be Based Solely On The Low Bid Among Eligible Participants.

Each bidder should submit its bid in the following straightforward format: (i) the geographic area or areas covered by the bid (see Questions 7 and 10 below); (ii) the annual dollar amount of subsidy that it requests to serve as the COLR for those areas, and (iii) verified facts demonstrating that it satisfies the criteria for participation (*e.g.,* financial fitness; see Question 3(a) below). The auction should be run over multiple rounds; at the end of each round, the lowest bid received for a given area will serve as the maximum bid for that area in the next round. There should be only one winner for each geographic area: the lowest subsidy that is required to serve as COLR. (For bids that cover multiple areas, additional rules for determining the low bid are described under Questions 7 and 10.) A descending-bid, simultaneous-close auction may be appropriate, but AT&T cannot be certain until the other parameters of the auction are established, such as the procedures for bids that cover multiple geographic areas, whether providers' identities and bids are made public in real time, and whether the Commission establishes rules for rejecting bids in certain circumstances.

In the event of a tie, the Commission may conduct a "tie-break" round of bidding between the tie bidders. If the extra round does not break the tie, the bidder that first offered the low bid should be the winner. If that rule does not break the tie, the Commission's Staff should conduct a coin flip with all tie bidders present.

C. The Auction Should Result In Only One COLR.

After the auction is concluded (and after the completion of an appropriate transition period, as described in response to Question 7), the winning bidder must assume the COLR obligation for the area or areas in question: the obligation to offer and be ready to provide the required minimum level of service to *all* potential customers in the area defined. There should be only one COLR for that area: the low bidder. The previous COLR's obligations as a COLR should therefore expire as soon as the new COLR's term begins. Otherwise, the winning bidder will not be undertaking a real COLR obligation, as part of that obligation will be borne by

another carrier (and in the worst case, the winning bidder may seek to water down its obligation further by "dumping" its least profitable customers on the alternative COLR). Establishing more than one COLR will almost certainly engender confusion among consumers, along with disputes about which COLR must actually fulfill the COLR obligation with respect to a particular customer. The term "carrier of last resort" is singular, and it is inherent in the nature of a *last* resort that there be only one "last" resort.

Once the COLR has undertaken the obligation to provide service at or below the established rate cap, all other price regulation in the supported area – for that provider and all other providers – should cease. The Commission has already held that all services are competitive throughout the state. To the extent there is any need for any transition to avoid "rate shock" in high-cost areas, the reverse auction will provide that protection. By definition, consumers would have access to essential services at affordable rates from the COLR pursuant to the auction. Moreover, the rates of competing providers would be restrained by competition from the COLR. The only price regulation should be the one voluntarily assumed by the winning bidder in a limited geographic area, in exchange for the support given by the Fund. That result best squares with the state's ongoing process towards deregulation.

3. (a) *The auction mechanism will require a bidding process predicated upon appropriate parameters of acceptable COLR service. What eligibility criteria for carriers and service quality standards should be established as a basis for reverse auction bidding? For example, what minimum standard of reliable 911 service would be necessary to qualify as a COLR as a result of a reverse auction bid?*

To be eligible for the reverse auction, providers should satisfy certain financial and performance qualifications, as described in response to Question 4. The Commission should also establish appropriate service quality standards up front, so that prospective bidders understand the level of their commitment before developing and placing their bids. Bidders should commit in their application that they will satisfy those standards. For the initial auction, the service quality requirements should be based on (i) any standards (including 911 service standards) that apply to all providers, and (ii) any service quality standards that apply to the existing COLR in a

given area, unless the Commission changes those standards symmetrically for the existing COLR. If there are no current service quality standards in a particular area, the Commission should "borrow" existing standards from analogous geographic areas, though in so doing it should maintain symmetry in applying any standards between alternative providers and technologies. For future auctions, the Commission may consider (based on the experience gained in the initial term) whether the initial standards should be modified. If the Commission modifies performance standards during the term awarded by the auction, the new standards should not take effect for the COLR until that term expires, as that could materially change the deal after the COLR has made its commitment.

To the extent existing service quality and performance standards would prevent any particular technology from participating in the auction, the Commission should consider whether those standards are necessary to protect consumers. If not, the Commission should consider modifying the standards as appropriate to fit the alternative technology, or dropping some standards entirely so the Fund remains technology-neutral. In addition, the Commission should not establish any criteria that would prevent any particular kind of technology from participating in the auction, as the auction (and the Fund) should be technology-neutral. In this regard, the Commission should update the definition of "basic service" as described in response to Question 1, as the current definition would prevent wireless and VoIP technologies from being considered.

3. (b) *Should COLR status be granted for only a limited time subject to periodic renewal? If so, what should be the duration of COLR status?*

The term of the COLR obligation – and of eligibility for Fund support – should be fixed in advance, so all bidders know up front what commitment will be required (and so that all bids are based on a common term). Further, the term should be long enough to allow the winning bidder a reasonable opportunity to recover its costs of deploying long-term facilities, and to reduce the costs of conducting renewal auctions (and of transitioning to a new COLR). A short term would drive up the annual cost (because the costs of long-term facilities would have to be recovered over a shorter period), and increase the risk of becoming a COLR (because the

winning bidder might be displaced soon), thereby leading carriers to submit higher bids. AT&T recommends that the Commission adopt a fixed term of 10 to 15 years. The Commission should begin the process for a new auction at least one year before the expiration of the term, so the new COLR is in place when the existing COLR's term expires.

Of course, to the extent a COLR becomes unable to perform, or does not substantially comply with its obligations, the Commission may terminate the carrier's COLR status and put the area up for a new auction (to select a replacement COLR). During the interim period before the auction is concluded, the COLR responsibility would continue to belong to the COLR that won the previous auction. The Commission should not, under any circumstances, force any other carrier – in particular, the ILEC that served as a COLR before the auction process began – to be a "default" or "backup" COLR. That would force the "default" COLR to undertake the obligations of being a COLR (such as the investment required to continue being ready to serve all customers in the area in case the auction winner defaults) without compensation. Such a biased system would be anti-competitive and unlawful.

4. *Should threshold standards, such as financial fitness, be adopted to qualify to bid in the auction? Should there be a bond required?*

To be qualified to bid, prospective bidders must meet minimum financial qualifications established by the Commission to back their commitments of performance. Each bidder's application to participate would disclose financial data demonstrating its ability to perform, such as credit ratings. While a performance bond may be necessary in some cases (*e.g.,* new providers with no financial track record) the Commission should not require a bond for carriers with established service records and credit ratings. In such cases, a performance bond provides no real added assurance, only added (and unnecessary) costs that would drive up the bid prices. For "new" providers that are not already serving as a COLR in the area to be supported, the Commission may require that their applications to qualify as a bidder include information as to how they plan to meet their obligation as a COLR if they win: for example, what facilities each carrier plans to deploy and where.

5. (a) *What sorts of regulatory compliance requirements should apply to a selected bidder? Should reliability standards be placed on COLRs?*

Before the auction, the Commission should clearly state the regulatory compliance requirements that will apply to a provider that wins the auction and becomes a COLR. As a starting point for the initial auction, the Commission should apply the same regulatory compliance requirements to a winning bidder that are currently applied to existing COLRs (that is, the compliance requirements that are specific to being a COLR, as opposed to compliance requirements that happen to be applied to the existing COLRs because of other obligations, such as those that apply under federal law).

5. (b) *What Commission audit requirements may be warranted to verify and confirm that a winning bidder follows through with commitments to meet such specified minimum basic service quality standards?*

Currently, there are no specific reporting or audit requirements to verify that a COLR is performing its obligations. To the extent an existing COLR or another established provider wins the auction in a particular area, no new requirements should be imposed. To the extent a new provider wins the auction, and its bid depends on the deployment of new facilities, the Commission may require that provider to report on the status of that deployment to ensure it occurs. Periodic verified status reports, along with a verification of completion, could be required, and those reports may be made subject to audit.

In addition, if a provider assumes the obligation to meet additional performance standards as a result of becoming a COLR, it should provide periodic reports demonstrating compliance with those standards. Such reports may be made subject to audit. The Commission should require that all audits of compliance with deployment and performance commitments be made in accordance with generally accepted standards issued by the American Institute of Certified Public Accountants.

If the Commission learns (*e.g.*, through a consumer complaint) that a COLR has refused service to any customer in the designated area, it may open an investigation and require the

COLR to furnish information at the Commission's request, as providers must do in any other Commission investigation.

5. (c) *Should any penalties for withdrawal, such as the difference between the winning bid amount and the next carrier or reauction bid amount, be imposed?*

If a COLR withdraws from the area for which it receives Fund support, the Commission should assess a penalty of up to one year of future support, as it will take approximately one year to conduct another auction and line up a new COLR. The Commission may require the carrier to post a bond or letter of credit for that amount, unless the provider has demonstrated a clear credit history and track record. If the Commission determines that a COLR has not fulfilled its obligations, the COLR should be subject to penalties that are commensurate with the violation. Possible penalties may include (i) the partial or total forfeiture of prior support payments and/or (ii) termination of support to the COLR for the area. In more serious cases, the Commission may debar the provider from further participation in the Fund or future auctions.

The Commission should also adopt general enforcement mechanisms similar to those adopted at the federal level. The Commission should debar any party from participating in or receiving money from the Fund if they are convicted of any criminal acts or held civilly liable for acts relating to their participation in the Fund.[5] In addition, the Commission should adopt procedures for the recovery of funds that are disbursed in violation of any provision of state or federal law or the Commission's rules (*e.g.*, as the result of a fraudulent report by the recipient).[6] As at the federal level, such sanctions should be limited to cases of fraud, waste, or abuse, as opposed to clerical or ministerial errors.[7] And, as with all other obligations of a COLR, the Commission should clearly establish the range of potential penalties in advance of the auction.

[5] *In the Matters of Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, Docket Nos. WC 05-195 *et al*., *Report and Order*, 2007 WL 2457407 (F.C.C.), FCC 07-150, ¶ 32 (rel. Aug. 29, 2007).
[6] *Id*. at ¶ 30.
[7] *Id*.

6. (a) *What service(s) should be included within the bid covered by the reverse auction? (Parties may incorporate, by reference, comments on CASF issues, to the extent deemed relevant.) What limitations or conditions should be placed on service(s) that may be included within (or excluded from) the bidding?*

Consistent with past practice, the Fund should only support basic service. Thus, bids for Fund support should only address basic service. However, as described under Question 1, the Commission should update the definition of basic service so that it is technology-neutral. In particular, the definition should accommodate other technologies such as wireless and VoIP, without extending the Commission's jurisdiction over these alternative technologies. To the extent the Commission establishes an Advanced Services Fund to support broadband, that fund should be administered separately, as it would be subject to a different set of requirements.

6. (b) *Are there other elements that should be part of bid than the amount of universal service support for the specific area?*

To make for an efficient, fair, and transparent auction, the amount of support requested should be the only variable considered in evaluating individual bids. Any requirements the winning bidder is to meet when it becomes a COLR (*e.g.,* service quality standards, penalties for non-compliance) should be fixed by the Commission and clearly set forth in advance of the auction, and they should be uniform for all bidders. The bid should simply acknowledge the provider's commitment to meet those requirements if it wins. AT&T describes its recommendations for these COLR requirements in response to questions 2-5 above.

6. (c) *Should bids be placed on total support, support per subscriber, support per household, or some other basis?*

The amount of each bid (and the ultimate award) should be based on the amount of total annual support requested. The essence of a COLR's obligation is to be *ready* to serve all customers in a given area, and the COLR must incur costs and invest in facilities sufficient to serve all customers. The COLR's competitors may pick off some of those customers, but the COLR must nonetheless be prepared to provide basic service to those customers. The COLR's obligation does not go away simply because the customer has left for a competing provider,

because the COLR still will need to maintain the necessary facilities. As a result, the number of subscribers or households actually served at any given moment does not reflect the financial commitment made – and the amount of support required – by the COLR.

While bid amounts should be based on the level of annual support, the Commission may choose to distribute support payments on a more frequent (*e.g.,* monthly or quarterly) basis to even out cash flow. The Commission should specify the disbursement timetable as part of the bidding rules.

7. (a) *In what geographic area(s) should the initial auctions be held?*

As is also described in response to Question 10, the Commission should use high-cost Census Block Groups as the "lowest common denominator" for the initial auction. The boundaries of CBGs should be based on the most recent census (for the initial auction, the 2000 census would apply). The identification of high-cost CBGs should be based on those areas in which the cost proxy exceeds the Commission-established benchmark, as determined by HM 5.3 in the update proceeding described in Section 2.2. However, if the existing COLR states that it is willing to remain the COLR in a high-cost CBG without any subsidy, that CBG should be removed from the auction. By definition, the auction cannot possibly yield a lower bid in that circumstance. In addition, the Commission should consider allowing existing providers to identify additional areas that require support and should be subject to an auction, and to present evidence demonstrating the need for support.

A provider's bid should cover at least one high-cost CBG. However, providers should be allowed to place a "contingent bid" on geographic areas that include multiple high-cost CBGs. Service providers are likely to achieve economies of scale by serving multiple CBGs, and they can factor in the savings to yield a lower bid than if they had to serve one high-cost CBG by itself. Consumers and the State would benefit by having more high-cost CBGs covered by the auction, at a lower cost. The bidder should be allowed to make a multi-CBG bid "contingent" on winning the COLR status for all the CBGs covered by the bid. If the bidder only won in some

CBGs, it might not achieve the same economies that it would have achieved if it won the entire area for which it sought COLR status, and the support amount would no longer serve as adequate compensation to the provider.

7. (b) *How many separate auctions will be required?*

In AT&T's view, there are simply too many unknown details of an auction process to answer this question at this time. AT&T suggests that after details of the auction process have been defined, the Commission should conduct a pilot program to observe how the auction process works. Then, after conducting the auction and identifying what, if any, changes are needed, the Commission could determine how many separate auctions will be required.

7. (c) *What is the appropriate transition time to phase-out existing COLR support and phase-in new COLR support? Should the same timeframe be used to phase-in coverage and other COLR obligations? Should build-out benchmarks be established?*

If the existing COLR does not win the auction for a particular CBG, the Commission should establish a reasonable transition period for the winning bidder to make ready to serve that CBG as the carrier of last resort, and for consumers to receive sufficient notice of the change in COLRs. AT&T recommends that the transition period last at least one year. This should give the new COLR more than ample time to deploy any facilities that may be required, and it will also give the existing COLR time to make its own arrangements for the new post-auction environment. Moreover, section 214(e)(4) of the federal Telecommunications Act of 1996[8] contemplates a maximum transition period of one year as sufficient to ensure that customers will continue to be served.

8. *Should one particular area be selected for a pilot project to test the operation of a reverse auction? If so, based upon what considerations?*

As described in response to Question 11, the Commission may wish to conduct a pilot project to test the reverse auction while the update of HM 5.3 cost is being done. The Commission should designate a small area to serve as the pilot by selecting one or more of the

[8] 47 U.S.C. § 214(e)(4).

CBGs with the very highest support levels and estimated costs, and by soliciting comment on the desirability of those specific areas. It is likely that the highest-cost areas will remain high-cost areas in the upcoming cost update, and these areas also represent the opportunities for the most cost savings in an auction.

9. *Should only one COLR be selected for each area, or should reduced subsidies be available to qualifying competitive carriers?*

The Commission should select only one COLR for each area: the winner of the reverse auction for that area. Selecting two or more COLRs would reduce the economies of scale that one carrier might achieve. Moreover, it would encourage gamesmanship, as neither carrier would truly be the carrier of *last* resort, forcing the Commission to resolve disputes about which carrier would be required to serve a given customer. Each carrier would have an incentive to "cherry pick" the profitable customers in a CBG (and still receive a subsidy) while forcing the other carrier to serve the unprofitable customers. It would be difficult, if not impossible, for the Commission to micro-manage each CBG and each customer to avoid such results.

For the same reason, support should not be available to carriers that do not have a COLR obligation. Non-COLR carriers would have every incentive to cherry pick the more profitable customers within a supported area and avoid serving the least profitable customers. The Commission should not *subsidize* or *encourage* cherry-picking by giving carriers Fund support without also requiring them to be a COLR. That result would be unfair to the provider that participates in – and wins – the reverse auction by making a commitment to be a COLR, and it would reward providers that sit out the reverse auction and then pick off subsidies after the auction is over. To the extent a carrier desires subsidies in a given area, it should participate in the reverse auction, submit a winning bid, and then undertake and fulfill the obligations of a COLR.

10. *Should the size of the service area subject to reverse auction bidding be set by the Commission or determined by the bidding process?*

As described in response to Question 7, the Commission should use high-cost Census Block Groups as the "lowest common denominator" for the auction: a provider's bid should cover at least one high-cost CBG. That way, the Commission can easily compare bids that cover the same CBG. However, providers should be allowed to place a "contingent bid" on geographic areas that include multiple high-cost CBGs. Competing providers should then have time to place competing bids for the same larger areas. To compare a multi-CBG bid against single-CBG bids, the Commission should select the multi-CBG bid if it is lower than the sum of the low bids for the individual CBGs that are included in the larger bid.

11. *What is a reasonable cost proxy to serve as an initial auction "reserve" or upper bound on bids that would be acceptable as the basis for payment of support levels? What is the most expeditious manner to derive an appropriate benchmark for setting such upper bounds? As a default, should any qualifying upper bid be at or below the existing B-Fund support level for designated areas subject to the auction? If the HM 5.3 Model is used to designate areas subject to the auction, should a cap be placed on the results? What is a reasonable cap?*

The Commission should use the HM 5.3 Model to designate areas subject to the auction, and to compute the initial auction "reserve" based on the updated assessment of costs described in section 2.2 below. AT&T does not recommend using the *existing* B-Fund support levels, or the cost estimates on which those support levels are based. The existing support levels and cost estimates were calculated using the CBG boundaries from the 1990 census. Moreover, the cost estimates were calculated years ago using a different cost model. The Commission should not base the auction – which will generate support amounts for several years to come – on maps and cost estimates that are already out of date, particularly when the update is underway. It is quite likely the update will reveal new high-cost areas that require support, and those areas would be excluded from the auction if the Commission were to use the old cost proxies. The better course would be to wait for updated costs to be completed. To the extent the Commission wishes to take some action in the interim, it could consider a pilot program for a few limited area (*e.g.,* the very highest-cost CBGs in the existing cost study) using the existing support amounts. If the

Commission does decide to use the old cost data, it should allow providers to present evidence regarding additional high-cost areas that were not identified in those data.

As described in further detail in Section 2.2, the Commission should not place a cap on the HM 5.3 amounts. The auction itself will result in the most accurate level of support required to meet the Commission's goals. It will proceed from the HM 5.3, which is a Commission-approved model that was specifically designed to calculate costs for a "least-cost" carrier, and which provides a reasonable estimate of those costs. Any further adjustment or cap on HM 5.3 results – beyond the adjustment provided by the deregulatory auction process – would likely entail litigation regarding the amount of the adjustment or cap. At best, the time and effort involved would be unnecessary, because the reverse auction would reduce support anyway if a reduction is warranted. Worse, an artificial adjustment could reduce support below the truly sustainable level, such that no provider would bid on the area.

12. *What sorts of cost proxy determinations or updates may be necessary or desirable as a basis to identify areas subject to bidding under the reverse auction? Is there a better approach to forecast service needs or the area for the duration of the COLR designation?*

As stated in response to Question 3, for those high-cost CBGs that have been successfully "auctioned off," the amount of the subsidy should be established by the auction, and the term of the subsidy should be established as 10-15 years. It would be inappropriate to conduct a new auction for that area during the term (unless the winning bidder has defaulted on its obligation), as that would allow competitors to take COLR support from the winning bidder after it has made the investments to carry out its commitments. Given that there should be no mid-stream auctions, it would be unnecessary to update cost proxy determinations for those areas, as the cost proxy updates are supposed to serve only as the "initial bid" for an auction. Further, it would be inappropriate to use cost updates in order to change support amounts during the term of a provider's commitment. That would in essence change the deal between the Commission and the winning bidder, after that winning bidder has already complied by investing in facilities.

For those high-cost CBGs that are not supported through the auction process – that is, where no carrier has bid on the COLR obligation – the amount of support available is obviously too low. In those events, the Commission should update costs and increase the support, and then reopen the auction for that area. Maintaining a reserve that proves too low but requiring a COLR to serve that area anyway (with support that is demonstrably too low) would be unfair and confiscatory.

13. *If an existing ILEC COLR does not submit a selected bid during the auction, should there be any additional requirements that the ILEC make its existing facilities in the designated area available to a new COLR?*

No. The Commission has no authority to make ILEC facilities available to a competitor. This is a matter of federal law. Any requirement that the ILEC make its existing facilities available to a competitor would – and must – be established and governed by federal law, and by the ILEC's interconnection agreements implementing federal law. To the extent that federal law requires the ILEC to make its facilities available, the Commission would not have the power to lift that requirement. Of course, the presence of a competitor willing and able to serve as a COLR may demonstrate there is no need for the ILEC to provide access to its facilities, and the FCC may well decide to lift or forbear from enforcing the federal requirements. But that is a matter for the FCC to decide in a separate proceeding. In addition, under federal law (section 214(e)(4) of the 1996 Act), the Commission must permit an Eligible Telecommunications Carrier ("ETC") to relinquish its ETC designation and cease providing universal service in an area served by more than one ETC.

Conversely, if federal law has *rejected* an access requirement, this Commission would not have authority to overturn federal law or impose any requirements that federal law has rejected. The Supremacy Clause of the Constitution mandates that "the Laws of the United States . . . shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."[9] Accordingly, state law or regulation is preempted

[9] U.S. Const. art. VI, cl. 2.

where it conflicts with or "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[10] Federal agencies' orders and regulations implementing federal law – like the FCC orders and rules implementing the Telecommunications Act of 1996 – have the same preemptive force as federal statutes themselves.[11]

That settled conclusion would apply with full force to any conflict between state law and the 1996 Act. The Act provides that state commissions cannot impose any requirement that would "substantially prevent implementation of the requirements of [Section 251] and the purposes of this part [Sections 251-261]."[12] Congress also forbade any state requirements that are "inconsistent with this part [Sections 251-261] or the [FCC's] regulations to implement this part."[13] Thus, Congress "has clearly stated its intent to supersede state laws that are inconsistent with the [Act]."[14] As Judge Posner succinctly put it, if "a state commission's regulations" are "inconsistent" with the 1996 Act, "they are preempted."[15]

Likewise, the Supreme Court has recognized that "[w]ith regard to the matters addressed by the 1996 Act," Congress "unquestionably" took "the regulation of local telecommunications competition away from the States."[16] Thus, states are no longer "allowed to do their own thing," but "must hew" to the "lines" drawn by Congress and the FCC.[17] And if a state is not "regulating in accord with federal policy" with regard to such matters, the federal courts are to "bring it to heel."[18] With regard to the 1996 Act, the Seventh Circuit has similarly recognized that "[a] conflict between state and federal law . . . is a clear case for invoking the federal Constitution's Supremacy Clause to resolve the conflict in favor of federal law."[19] The FCC, too, has held that "state decisions that impose . . . an obligation" to unbundle where the FCC has

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[10] *Geier v. American Honda Motor Co.*, 529 U.S. 861, 873 (2000).
[11] *Fidelity Federal Savs. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 153 (1982).
[12] 47 U.S.C. § 251(d)(3).
[13] *Id.* at § 261(c).
[14] *Verizon North, Inc. v. Strand*, 309 F.3d 935, 940 (6th Cir. 2002).
[15] *Wisconsin Bell, Inc. v. Bie*, 340 F.3d 441, 443 (7th Cir. 2003).
[16] *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378 n.6 (1999).
[17] *Id*.
[18] *Id*.
[19] *Wisconsin Bell*, 340 F.3d at 443.

rejected such an obligation "are inconsistent with and substantially prevent the implementation of the Act and the [FCC's] federal unbundling rules and policies," and are therefore preempted.[20]

Any attempt to overturn federal law would be particularly improper in the context of Fund support. Consider, for example, federal law on unbundled access. The FCC has established a "nationwide bar" on unbundling of certain network elements, such as local circuit switching, and it has barred unbundled access to other network elements in certain circumstances.[21] There are two reasons why the FCC drew these clear boundaries on unbundled access. First, competing carriers would not be "impaired" without unbundled access (because they have ample alternatives to using the incumbent's facilities), and thus do not need the subsidy of low, state-regulated prices.[22] Second, an unbundling requirement would be harmful, because unbundled access discourages carriers from investing in their own facilities.[23]

If the Commission were to try reversing the FCC's decision and imposing access requirements, it would create the same harmful results that the FCC sought to avoid, by subsidizing a provider that chose not to invest in its own facilities but to lease the incumbent's facilities instead. To make matters worse, the Commission would give that provider a *second* subsidy, in the form of Fund support. Plainly, the Commission should not adopt such a course.

The Commission need not be concerned with requiring access in the event the ILEC is not the winning bidder. A non-winning bidder would have appropriate incentives to make its network available in an economic sense via non-regulated means (*e.g.*, commercial agreements). Requiring access at uneconomic terms would undermine the bidding process. The auction should give everyone an opportunity to make their bids; the bidders then need to bid based on *their* costs of meeting the requirements, and the best bid will win. If the ILEC network is the best option, the ILEC should win the bid. It is not fair to the ILEC to "sell" the COLR rights and

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[20] *In the Matter of BellSouth Telecomms., Inc.*, WC Docket No. 03-251, *Memorandum Opinion and Order and Notice of Inquiry*, 20 FCC Rcd. 6830, FCC 05-78, ¶¶ 1, 17 (rel. Mar. 25, 2005).
[21] *In the Matter of Unbundled Access to Network Elements Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313 & CC Docket No. 01-338, *Order on Remand*, 20 FCC Rcd. 2533, FCC 04-290 (rel. Feb. 4, 2005) ("*TRRO*"), *aff'd*, 450 F.3d 528 (D.C. Cir. 2006).
[22] *See*, *e.g.*, *TRRO* ¶¶ 199, 204 (discussing unbundled switching and UNE Platform)
[23] *See*, *e.g.*, *id.* at ¶¶ 210, 218 (discussing unbundled switching and UNE Platform)

responsibilities to another provider, but then essentially place new service obligations, presumably without access to any support, on the ILEC.

The competitive opportunity is in the auction itself, and it is a real and significant opportunity. No further steps need to be taken to create other competitive opportunities. It is questionable whether even the requirements of section 251 make sense in a post-auction scenario. To the extent the FCC would want the provisions of section 251 to apply in an area subject to an auction, the FCC should apply section 251 to the auction winner. To that end, as part of its bidding requirements the Commission should require winners to support being treated like an ILEC, pursuant to section 251(h)(2), for purposes of section 251 and to support a non-winning ILEC's petition for forbearance from sections 251/271 in the auction area, or other efforts to seek relief from those requirements.

2.2 Cost Proxy Model Update Implementation

1. *In order to mitigate the risks that the HM 5.3 Model may produce anomalous results, how, or in what manner, should the total investment calculation produced by the HM 5.3 Model be capped to avoid excessive subsidies?*

The Commission should not adopt caps or other changes to the investment calculation produced by the HM 5.3 Model, once that Model has been adapted to estimating universal service costs at the CBG level. Question 1 proceeds from a false premise: the theory that HM 5.3 may produce "anomalous results" or "excessive subsidies." There is no basis for such a theory. HM 5.3 is the model chosen by the *Commission* for use in UNE cost proceedings. It was thoroughly vetted in two lengthy UNE cost proceedings to establish prices for the state's two largest incumbents, AT&T and Verizon. And it is designed to estimate costs for a hypothetical "least cost" carrier. If anything, then, HM 5.3 will *underestimate* costs and subsidy amounts.

Even if one were to accept the erroneous premise that HM 5.3 might somehow produce anomalous results, there is no need for a cap or other modification, and thus, no need to go through the expense of litigating and deciding how such a cap would be developed. The Commission has already adopted reverse auctions as a method to avoid excessive subsidies. The

cost amounts developed through HM 5.3 are merely a starting point in determining subsidy amounts. If the calculated subsidy amounts for any CBG are truly "excessive" in the real world – as opposed to being *called* excessive on paper by partisan advocates – service providers will quickly bid to become the carrier of last resort in that CBG, and competitive bidding will lower the subsidy amount to the minimum amount that service providers are willing to accept. There is no need to impose a separate, regulatory cap where the Commission has already adopted a deregulatory solution.

2. *Why should any other adjustments be considered?*

No other adjustments to the HM 5.3 should be considered. The Commission has already thoroughly vetted HM 5.3 in two extensive cost proceedings, and it plans to conduct a reverse auction that is designed to adjust the results that come out of HM 5.3. AT&T does not agree with all of the Commission's decisions in the UNE cost proceedings, but it does understand the Commission has decided those matters, and it also understands there is no time to re-litigate them or reinvent the wheel now. Opening the floor to suggestions would simply invite parties to advance self-serving proposals that will waste time and prevent the parties and the Commission from getting to the real work of updating costs and then conducting the auctions.

3. *What other possible adjustments to the cost proxy should be considered in order to avoid excessive subsidies (e.g. limiting support only to the operations and maintenance costs for existing lines as derived from the model)?*

As demonstrated in response to Question 1, the Commission should not consider adjustments to the cost proxy. First, HM 5.3 is already designed to avoid "excessive subsidies," as it is a least-cost model adopted and vetted by the Commission in extensive cost proceedings. Second, HM 5.3 is simply a starting point for a competitive reverse auction, which provides yet another method to reduce subsidy amounts to the bare minimum.

In particular, the Commission should not limit support to the operations and maintenance costs for existing lines. Such a limitation would be a direct violation of the Consensus Costing Principles that the Commission has held applicable "to all services, new and existing, regulated

and non-regulated, competitive and non-competitive."[24] The Commission clearly articulated those principles in D.96-10-066, stating that "costs should be long run in nature," that "costs should be forward-looking," and that they "should incorporate *all* the costs caused by providing basic residential service."[25] Thus, the carrier of last resort receives compensation (either through rates or through Fund support) for "all the costs" associated with universal service. The Commission applies the same long-run cost principles in many other regulatory contexts, most notably in establishing UNE prices.

Moreover, limiting support to operating costs ignores the very real costs of deployment. Facilities do not last forever; they depreciate and will eventually have to be replaced, and the cost of that depreciation is a necessary part of the costs of providing service. If the Fund did not compensate providers for that cost, it would discourage providers from making the investments necessary to replace existing facilities where needed, and the quality of service in high-cost areas would decline. More immediately, if the initial support "bid" for the reverse auction is not sufficient to cover the cost of depreciation, it will discourage any provider from bidding in the first place, and thus hinder the competitive process that the Commission contemplates.

4. *What other adjustments to the HM 5.3 Model may be appropriate to streamline the updating process while ensuring that the resulting cost proxies are reasonable for deriving B-Fund support levels as an interim transition to the reverse auction?*

The Commission should not adopt any adjustments to HM 5.3 in the name of streamlining the update process. Indeed, the Commission should *avoid* adjustments, as the best way to streamline the update process is to proceed with the HM 5.3 without adjustments. As AT&T has explained in previous comments, the Commission has already thoroughly vetted the inputs and assumptions for HM 5.3 in two extensive cost proceedings. There is no need to reinvent the wheel here. Giving parties another chance to litigate over any inputs and

[24] *Re Open Access and Network Architecture Development*, Decision No. 95-12-016, *Interim Opinion Adopting Cost Methodology Principles and List of Basic Network Functions for Which Cost Studies Are to Be Performed*, 62 Cal. P.U.C.2d 575 (Dec. 6, 1995), *mimeo*, Appendix C, p. 5 (Consensus Costing Principle 9).
[25] *Re Universal Service and Compliance with the Mandates of Assembly Bill 3643*, Decision No. 96-10-066, *Opinion*, 68 Cal. P.U.C.2d 524 (Oct. 25, 1996), *mimeo*, p. 107.

assumptions will simply encourage them to put forth self-serving proposals that will take time to evaluate and litigate. The parties and the Commission would then be bogged down in litigation before even beginning to run the cost models (and before even beginning the reverse auction process). The most efficient way to proceed is to start the update process promptly, and to minimize opportunities for litigation throughout.

5. *What procedural measures may be necessary in order to facilitate the timely production of cost model runs, provision for discovery, protection of proprietary data, and other measures to develop an adequate record on cost model updates?*

The procedural measures existing for all proceedings are sufficient to develop an adequate record on cost model updates.

3.1 Transitional Basic Rate Caps

1. To promote an orderly transition and prevent sudden large rate increases, what maximum level above currently authorized caps should be set as the revised cap on basic rates for each respective ILEC before full pricing flexibility is to take effect?

2. What period of time is appropriate for the phase-in of increases in the caps on ILEC basic rates to transition from current levels to a level at which further cap restrictions can be eliminated and full pricing flexibility implemented?

AT&T recommends that AT&T California's maximum tariffed basic rate plus federal charge (End User Common Line or "EUCL") be allowed to go up, over two years, to the rates charged by other ILECs in California. The following table shows the current ILEC rates and EUCL for flat-rate basic residential service.

	Rate	**EUCL**	**Total**
AT&T	$10.69	4.39	15.08
Verizon	$17.25	6.50	23.75
Frontier	$17.85	6.50	24.35
SureWest	$18.90	6.50	25.40

There are a number of reasons supporting the proposed cap increases over two years. First, after two years, the proposed increases would simply bring AT&T California's basic rate plus EUCL in line with the rates paid by customers of other ILECs *today*. AT&T California's maximum rate would conclusively be reasonable.

Second, increasing AT&T California's basic rate cap to the other ILECs' current charges is reasonable given that AT&T California has not increased rates since 1995 – more than a dozen years. This would equate to less than a 5 percent annual increase since 1995.

Finally, as the Commission has concluded, the communications market is fully competitive.[26] Pricing regulation distorts competitive choices and causes harm to consumers.[27] The Commission must minimize the harm by meaningful movement in the price caps for basic service and attainment of full pricing flexibility so prices can reflect costs and market conditions. AT&T's proposal of allowing the maximum rate to increase up to levels already paid to other California ILECs, after which full flexibility is attained, would reasonably balance the Commission's concern regarding the potential "rate shock" of full and immediate pricing flexibility with the benefits of a fully competitive, deregulated market.

3.2 Certification Process To Qualify For B-Fund Support

What process should be implemented whereby the COLR shall certify that its services and rates in high-cost areas are reasonably comparable to services offered in urban areas once full pricing flexibility takes effect?

A process for such certification is unnecessary. Basic residential service will remain tariffed. The services offered in high-cost areas and urban areas will be apparent. The rates will be comparable because once full pricing flexibility is attained, competition will ensure any differences in rates are reasonable.

3.3 Broadening The Base For Eligibility For B-Fund Support

Should existing rules for eligibility to receive B-Fund support be modified to include wireless and other intermodal carriers?

What other considerations or revisions in existing rules may be appropriate or necessary to accommodate such a change?

The B-Fund rules must allow all technologies to participate so that the Commission's program enables competition, resulting in the most choice and lowest prices to consumers. As

[26] *Re Rulemaking to Assess and Revise the Regulation of Telecommunications Utilities*, Decision No. 06-08-030, *Opinion*, 2006 WL 2527822 (Cal.P.U.C. Aug. 24, 2006), *mimeo*, pp. 117, 265 (Findings of Fact 50-51).
[27] *Id.* at 152.

has been explained above, requiring B-Fund participants to offer Lifeline service, which has to be tariffed, would effectively preclude wireless and VoIP providers from participating.

3.4 Standards/Procedures For Future Period Review Of The B-Fund Program

What standards and procedures should be applied for future periodic review of the B-Fund program in order to ensure that the program continues to be effective in meeting the Commission's universal service goals?

The answer to this question depends on whether the Commission embarks on the auction path or not. The auction path, established terms for the winner, and a new auction at the end of that term would suffice. Without auctions, the Commission should redefine the areas and support available once every ten years, based on new Census Block Groups ("CBGs") that come from the new census done once every 10 years. Cost changes within those time periods are taken care of by the market, as carriers with lower costs win customers by lower prices without increasing the support (because the $36 benchmark is used to calculate support).

3.5 Streamlined Administration Of B-Fund Receipts And Disbursements

Through what standards and procedures can the administration of the B-Fund program be made more streamlined and efficient?

AT&T has addressed this in its original opening comments, dated September 1, 2006, at pages 26-27.

Dated at San Francisco, California, this 9th day of November 2007.

Respectfully submitted,

/s/
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CERTIFICATE OF SERVICE

I, Morena E. Lobos, hereby certify that I have this day served a copy of the foregoing **PHASE II COMMENTS OF AT&T CALIFORNIA (U 1001 C); AT&T ADVANCED SOLUTIONS INC. (U 6346 C); AT&T COMMUNICATIONS OF CALIFORNIA (U 5002 C); TCG SAN FRANCISCO (U 5454 C); TCG LOS ANGELES, INC. (U 5462 C); TCG SAN DIEGO (U 5389 C); AND AT&T MOBILITY LLC (NEW CINGULAR WIRELESS PCS, LLC (U 3060 C); CAGAL CELLULAR COMMUNICATIONS (U 3021 C); SANTA BARBARA CELLULAR SYSTEMS LTD. (U 3015 C); AND VISALIA CELLULAR TELEPHONE COMPANY (U 3014 C))** on all persons on the official service List in **R.06-06-028**, via e-mail, hand-delivery and/or first-class U.S. Mail.

Dated this 9th day of November 2007 at San Francisco, California.

AT&T
525 Market Street, 20th Floor
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/s/
Morena E. Lobos

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